



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Mark Danaj

SUBJECT: RETIREE HEALTHCARE

DATE: 05-27-08

Approved

Date

COUNCIL DISTRICT: N/A
SNI AREA: N/A

RECOMMENDATION

It is recommended that the City Council:

1. Accept this staff report on retiree healthcare.
2. Direct staff to collaboratively develop options for a prefunding plan, ramping up over a multiple year period to full pre-funding of the actuarially determined annual required contribution for retiree healthcare.
3. Direct staff to move forward with total health management and risk reduction strategies through the wellness program.

OUTCOME

Approval of the recommendations will permit City staff to advance with the applicable stakeholders in determining the most effective and comprehensive solutions to the current unfunded liability for retiree healthcare. A commitment to full pre-funding, within terms that are acceptable to the City in light of budget constraints as well as employees who fund half the expense of the retiree medical benefit through payroll deductions, will have a positive long-term effect on the City of San José's ability to remain economically viable.

BACKGROUND

The Government Accounting Standards Board (GASB) issued accounting pronouncements in 2004 which require employers to obtain actuarial valuations of their retiree healthcare benefits, and to disclose those liabilities in their Comprehensive Annual Financial Reports (CAFR). Further, GASB established a standard for reporting on these retiree healthcare costs through the actuarial valuations that compute the annual costs that would be required if such benefits were amortized over a maximum of 30 years to fully meet that liability. GASB refers to these annual costs as the Annual Required Contribution (ARC).

Three actuaries were retained by the Retirement Boards and the City to meet this requirement. Although the actuaries' calculations varied, the range of the unfunded liability estimates was from \$1.2 to \$1.65 billion.

In response to the size of this projected liability and its potential impact, the City Council discussed retiree healthcare liability as an agenda item during two Council meetings in August of 2007. From these sessions, the City Council directed staff to:

1. Engage stakeholders in identifying strategies and alternatives to address our unfunded liability for retiree healthcare. Stakeholders will include, at a minimum, employees, City Labor Alliance, Executive Management Forum, retiree associations, retirement boards, and South Bay Labor Council.
2. Continue to survey how other cities and counties are addressing their unfunded liabilities.
3. Engage experts, identified by the Administration and stakeholders, as necessary to evaluate strategies and approaches that are identified by stakeholders or have been implemented in other cities or counties.
4. Study how pre-full funding of benefits can be accomplished through a phased-in approach.¹

The City engaged the services of three facilitators for this process: Paul Hackleman, a consultant with IC Benefits, Bill Hembree, the Director of the Health Research Institute in Concord, and Shawn Spano, a communication consultant and professor at San José State University. Facilitators met with identified stakeholders in 10 meetings from November, 2007 through April, 2008 to solicit their input and capture their ideas. Furthermore, the consultants completed a study to identify how other organizations are addressing their unfunded liabilities.

The work of a Joint Boards Committee: Solutions to Retiree Healthcare, which was assembled in October of 2007, largely completed steps three and four of the Council direction over a seven month period. Composed of three members of the Federated Board, three members of the Police and Fire Board, and Human Resources Director Mark Danaj, the Joint Boards Committee met with a variety of experts such as actuaries, bond rating agencies, healthcare providers, and consultants to produce informative recommendations on the best ways to address funding retiree healthcare benefits and confronting the challenge posed by healthcare inflation.

¹ City of San José Council Memorandum, August 28, 2007.

ANALYSIS

After extensive research and collaboration, recommendations for different methods to achieve pre-full funding of benefits are in development. As options are being considered, limitations on how pre-full funding of benefits can be reached by the City of San José have also become apparent. Based on legal counsel provided by the Office of the City Attorney, retiree healthcare benefits are considered a “vested” benefit similar to the pension benefit itself given that healthcare benefits are written into the Municipal Code as part of the City’s retirement plans. Supported by this report, the City will not recommend changes to retiree healthcare benefits (as specified in the Municipal Code) for current employees or current retirees at this time.

Upon consideration of this limitation, the City and employees covered by the current benefit share an interest in addressing the costs of retiree healthcare benefits for many reasons, including that the Municipal Code specifies that the costs are shared between the City and employees. As explained in the retiree healthcare Council memo on July 24, 2007, drastically reducing “or even the elimination of healthcare benefits for future employees with no change in benefits for current employees would yield virtually no decrease in the liability for years. This is because the estimated unfunded liability primarily consists of the costs to provide benefits to current retirees and current eligible employees when they retire.”² Therefore, solutions adopted towards reducing the retiree healthcare liability will need to be creative and results may not be seen immediately.

EVALUATION AND FOLLOW-UP

As previously stated throughout this memo, staff has taken the appropriate action to address items one through four of the direction requested by Council on August 28, 2007. With the help of its consultants and in partnership with the Joint Boards Committee, staff has included several attachments to this staff report.

Please refer to the document labeled ‘Council Report’ from I.C. Benefits Consulting which serves as a final report to Council on the facilitation of stakeholders. Prepared by the consultants, this report summarizes 10 key themes from stakeholder sessions and identifies what strategies other employers throughout the nation are considering in addressing their liability. For specific stakeholder suggestions, the stakeholder feedback session notes from each meeting are provided in addition to the responses to open questions which originated in the feedback sessions. Additionally, the handouts provided to participants of the feedback sessions have been attached to this memorandum. Materials include the meeting agenda, background information, a glossary of terms, and a 2007 Kaiser Family Foundation graph which demonstrates a national perspective on healthcare costs. Also attached, please review the citation list for all reports that were considered during the research process.

The Joint Committee on Solutions to Retiree Healthcare final report is provided as a recommendation from both the Police and Fire and Federated Boards. The proactive work of this committee resulted in the completion of the council directives three and four. This

² City of San José Council Memorandum, July 24, 2007.

comprehensive report provides solutions to funding retiree healthcare, explanation of the deliberative/consultative process and findings of the committee. The information compiled in this report is the result of continuous communication with experts and thorough analysis of how pre-full funding of benefits can be accomplished through a phased-in approach.

PUBLIC OUTREACH/INTEREST

Not applicable. As directed by Council, outreach has been conducted with stakeholders including the City Labor Alliance, Executive Management Forum, retirees, current employees, retirement boards, and the South Bay Labor Council. Discussion with the public, community groups and/or governmental agencies does not apply to the subject discussed in this report.

- ☐ **Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- ☐ **Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- ☐ **Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

COORDINATION

The Human Resources Department has consulted with the City Manager's Office, the Office of the City Attorney, Joint Boards Committee on Solutions to Retiree Healthcare and the Retirement Services Department for the preparation of this report.

FISCAL/POLICY ALIGNMENT (If applicable)

Not applicable at this time. Staff will return to Council with cost-benefit and economic impact information if/when a plan to pre-fund retiree healthcare benefits has been developed.

CEQA

Not a project.

MARK DANAJ
Director of Human Resources

For questions please contact Mark Danaj, Director of Human Resources, at 408-975-1475.

Attachment